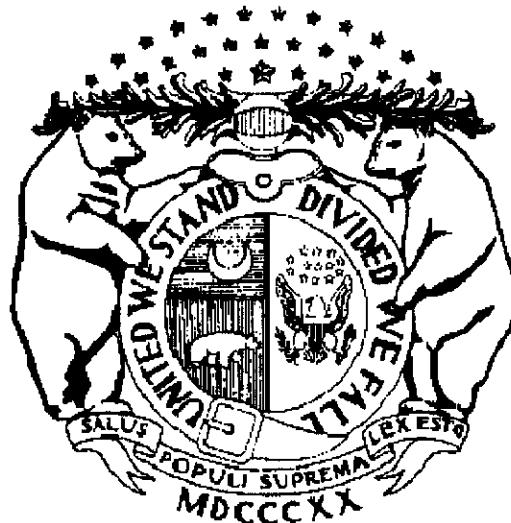


REPORT OF  
FINANCIAL EXAMINATION

**Farmers and Laborers  
Cooperative Insurance Association  
of Audrain County**

As of:

December 31, 2005



STATE OF MISSOURI

DEPARTMENT OF INSURANCE  
JEFFERSON CITY, MISSOURI

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October 1, 2006  
Mexico, MO

Honorable Dale Finke, Director  
Missouri Department of Insurance  
301 West High Street, Room 630  
Jefferson City, Missouri 65101

Sir:

In accordance with your examination warrant, a financial examination has been made of the records, affairs and financial condition of the

**Farmers and Laborers Cooperative Insurance Association of Audrain County**

hereinafter referred to as such or as the "Company". The Company's home office and principal place of business is located at 1005 W. Monroe Street; Mexico, Missouri 65265; telephone number (573) 581-1360. This examination was conducted at the home office in Mexico, Missouri. The examination began August 14, 2006, and concluded October 1, 2006.

**SCOPE OF EXAMINATION**

Period Covered

The Company was last examined by the Missouri Department of Insurance in 2001 for the year ending December 31, 2000. The current examination covers the period from January 1, 2001, through December 31, 2005, and was conducted by an examiner from the Missouri Department of Insurance.

## Procedures

This examination was conducted using the guidelines set forth by the practices, procedures and applicable regulations of the Missouri Department of Insurance and statutes of the State of Missouri.

### Comments - Previous Examination Report

The general comments and recommendations in the previous examination report and the subsequent action taken by the Company are listed below.

**Comment #1:** “The Board should develop a comprehensive policies and procedures manual to ensure consistent application of the Board’s directions. An investment policy should be included that ensures compliance with statutory and regulatory requirements. It is recommended that the Board of Directors set forth the Company’s policies in written form. These policies should be maintained in an up-to-date manual and made available to Company management and personnel.”

**Company Response:** Yes, this is one of the items our last examination expressed a need for. The board does need to get samples from some source and implement a manual for the Board’s direction for the Company. Also, an investment manual needs to be implemented.

**Current Examination Findings:** No policy or procedures manual has yet been created.

**Comment #2:** “The Board should ensure that adequate fidelity coverage is maintained according to the minimum recommendations of the National Association of Insurance Commissioners.”

**Company Response:** Company has raised its Fidelity Bond to \$100,000.

**Current Examination Findings:** Company has raised its Fidelity Bond to \$100,000.

**Comment #3:** "The Board should obtain written agreements with all its agents."

**Company Response:** The board is waiting for the three agents to draft a contract that both parties can live with. The last outline was not approved by the board. At the present time, one agent is writing a copy for the Board inspection.

**Current Examination Findings:** The Company has no signed agreement with its agents.

**Comment #4:** "The Board should implement an independent adjusting function within the Company. This will help ensure that the large amount of claims paid by the Company is adequately monitored and proper segregation of duties is maintained."

**Company Response:** No staff adjuster could be found for the amount that the Board was willing to pay.

**Current Examination Findings:** Company has not hired an adjuster to this date.

## **HISTORY**

### General

The Company was organized and incorporated on April 6, 1891 as Farmers and Laborers Cooperative Insurance Association. On October 9, 1962, the Company amended its Articles of Incorporation and changed its name to Farmers and Laborers Cooperative Insurance Association of Audrain County. In February 1985, the Company amended its Articles of Incorporation to comply with Sections 380.201 through 380.591 RSMo (Extended Missouri Mutual Companies). At that time, a new Certificate of Authority was issued by the Missouri Division of Insurance.

### Management and Control

A board of seven directors provides oversight of the Company. Each director serves a three-year term with two or three directors elected each year. Directors are elected at annual member meetings held on the second Tuesday in February. Special meetings of the members may be called by the Board of Directors at any time or upon petition of one-fourth of the members. Ten members constitute a quorum at annual member meetings and proxy voting was not addressed in the Articles of Incorporation.

The Board of Directors consisted of the following members as of December 31, 2005:

<u>Name/Address</u>	<u>Occupation</u>	<u>Term</u>
Lloyd H Bruns 16969 Audrain Road 975 Thompson, MO 65285	Farmer	2004 to 2007
Keith Dowell 80 Audrain Road 381 Mexico, MO 65265	Farmer/Business owner	2005 to 2008
Douglas Erdel Cedar Ridge Cove Mexico, MO 65265	Farmer/Retired	2003 to 2006
Daniel Kilbourn 9573 Audrain Road 124 Centralia, MO 65240	Farmer	2004 to 2007
Kenneth G. McDonald 614 North Walnut Vandalia, MO 63382	Farmer/Retired	2005 to 2008
Harry N. Riechers, Vice-president 1626 Churchill Place Mexico, MO 65265	Farmer	2003 to 2006
Alvin Wagner - President 31715 Audrain Road 416 Rush Hill, MO 65280	Farmer	2003-2006

In addition, Vernon Floyd is the Secretary/Treasurer, general manager and one of the agents of the Company.

The Company does not have a policies and procedures manual as recommended in the previous examination. Development of such a manual would help ensure clear and consistent understanding of the Board's direction and policies. For example, a Board policy regarding investments would provide a long-term strategy for the Company's investment practices and help ensure compliance with statutory limitations. Parts of the assets reviewed during this examination should have been non-admitted because they were not approved investments pursuant to Section 380.471 RSMo. All of the Company stocks are limited to the 20% and 5% rule in aggregate with the bonds pursuant to 20 CSR 200 -12.020.

Also, the cash investments are over the \$100,000 FDIC insured deposit limit. It is recommended that the Company establish a comprehensive investment policy that will identify the types of investment this company wishes to invest in. A comprehensive policy would identify other investment opportunities that meet the Board's long-term goals with respect to liquidity, risk and return objectives and compliance with statutory and regulatory limits.

The Board should develop a comprehensive policies and procedures manual to ensure consistent application of the Board's directions. An investment policy should be included that ensures compliance with statutory and regulatory requirements.

#### Conflict of Interest

Signed conflict of interest statements are obtained annually from all directors and the manager. These statements did not disclose any conflicting situations and no apparent conflicts of interest were identified during this examination.

### Corporate Records

Articles of Incorporation, Bylaws, and minutes from the annual meetings and board meetings were reviewed. The Company is following the guidelines established in the Articles of Incorporation and Bylaws. The review of Board meeting minutes indicated that the Board is adequately informed regarding the Company's operations.

The Board formally acknowledged receipt of the previous Missouri Department of Insurance report of examination during its August 28, 2001, meeting. Attendance at the Board and annual meetings appears satisfactory.

### **FIDELITY BOND AND OTHER INSURANCE**

The Company has acted to help minimize the risk exposure of the business. The Company has a fidelity bond for \$100,000 from Western Surety Company. This bond meets the minimum recommended by the National Association of Insurance Commissioners for a company of this size.

The Company has three agents and provides errors and omissions coverage (each with an aggregate limit of \$500,000). The directors and officers have insurance coverage, with an aggregate limit of \$2,000,000. The agents and directors and officers insurance is provided through MAMIC Mutual Insurance Company. The Company has a property and general liability policy for its home office from Grinnell Mutual Reinsurance Company (Grinnell) with a limit of \$60,000 for the property and \$1,000,000 aggregate for general liability.

## **EMPLOYEE BENEFITS AND PENSION PLANS**

The Company has one full-time employee in the capacity as bookkeeper. The Company's manager is not considered an employee since he is an agent for the Company and is compensated primarily through commissions. The bookkeeper receives two weeks of paid vacation (after two years of employment) and one-half day of sick leave per month. No other benefits are provided and the Company has no retirement plan.

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

### Territory and Plan of Operations

The Company is licensed by the Missouri Department of Insurance to operate under Sections 380.201 through 380.591 RSMo (Extended Missouri Mutual Companies). The Company is authorized to write fire, windstorm and liability coverages throughout the state but writes primarily in Audrain and surrounding counties. The Company does not write liability coverage but provides that coverage through Grinnell. The Company's agents take applications and claims notification. Mr. Floyd and two other agents serve as the Company's sales force. Advertising consists primarily of various promotional activities in the community.

### Policy Forms and Underwriting Practices

The Company uses policy forms supplied by Grinnell Mutual Reinsurance Company. The Company issues three-year renewable policies. Homeowners and farmowners packages are provided by combining the property coverages underwritten by the Company with the liability coverage underwritten by Grinnell.

Inspections are conducted by the writing agent and underwriting is performed by the manager. Reviews for initial fire and wind claims are made by the Company's agents while the manager adjusts the majority of claims. All liability claims are adjusted by Grinnell. The Company will use outside adjusters on large or suspicious fire claims. Records of claim filings are kept in the policy file and recorded in a detailed claims register.

The Board should require signed agreements with all its agents. Currently, only the manager has signed an agreement which outlines the expectations of the Company. These agreements should cover requirements to be an agent for this Company and the compensation arrangements with the agents.

#### **GROWTH AND LOSS EXPERIENCE OF THE COMPANY**

Year	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Admitted Assets	\$9,696,422	\$9,030,111	\$7,048,998	\$6,548,954	\$6,331,793
Liabilities	\$844,912	\$780,135	\$490,930	\$431,709	\$443,442
Gross Assessments	\$1,440,202	\$1,347,614	\$878,741	\$845,156	\$756,718
Losses Incurred	\$665,669	\$742,165	\$493,285	\$839,610	\$307,342
Investment Income	\$370,119	\$375,739	\$422,578	\$347,070	\$362,657
Underwriting Income	\$300,598	\$122,343	\$103,416	(\$72,466)	\$211,225
Net Income	\$601,534	\$424,337	\$444,297	\$228,894	\$476,671
Policies In Force	3,035	2,966	2,416	2,474	2,435

These figures are based on data from annual statements provided by the Company. Losses incurred do not reflect any reinsurance recoveries. Underwriting income shows wide fluctuations partly because the Company is reinsured through a single aggregate excess of loss agreement. The Company may experience larger levels of underwriting income but does so with increased risk. Investment income has been stable and the Company is growing in terms of total policies in force

and in gross premium income. The Company is now one of the largest of its type in the state.

The growth and size of this Company emphasizes the need for improvements in its organizational structure. The management agreement the Board developed in response to a previous examination recommendation lists several responsibilities of the manager. However, because all these duties are vested in one individual, there is no segregation of duties. This is a critical internal control that is missing in this Company. Implementation of this internal control is especially important since the Company does not have an annual independent audit.

The Board should consider a separate claims adjusting function within the Company. The aggregate excess of loss reinsurance arrangement places a large portion of the loss payment responsibility directly on the Company. This responsibility, coupled with the increased reporting and operational responsibilities of the manager, illustrates the need for a separate adjuster. This would also help to improve the segregation of duties issue discussed above.

## **REINSURANCE**

### Assumed

The Company does not assume any reinsurance.

### Ceded

The Company has reinsurance through an aggregate excess of loss agreement with Grinnell Mutual Reinsurance Company. This agreement will pay all claims that exceed the attachment point for wind and fire losses. The attachment point is determined by a formula that is a function of the amount of fire risks in force, the Company's ten year gross fire loss ratio and other adjustment

factors. The attachment point in contract year 2005 was \$1,057,567. That increased to \$1,137,014 for contract year 2006.

Premiums for this contract are also derived from a formula and are approximately \$0.33 per \$1,000 of fire risk in force at the end of each month during the contract year. This amount calculates to approximately 7% of direct premiums written.

### **ACCOUNTS AND RECORDS**

The Company maintains financial records primarily in manual systems with some records maintained in automated systems. The Company maintains its policyholder information and premium data using a software package prepared by Central Missouri Computer Center. Premium receipts are also manually recorded in a ledger. Manual claim information is kept in separate files and recorded in detailed claims registers.

Overall, the Company's accounting system appears to be adequately meeting management's expectation in its financial reporting requirements, however in comparison to other Missouri Mutuals of this size and volume of business this Company lacks in its computized accounting system.

A public accounting firm is used to prepare the Company's financial statements, tax returns and annual statement. The annual statement was prepared on an accrual basis and included an unearned premium reserve. Changes in the annual statement are discussed in the "Notes to the Financial Statements" section of this report.

## **FINANCIAL STATEMENTS**

The following financial statements, with supporting exhibits, present the financial condition of the Company at December 31, 2005, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the annual statement and/or comments regarding such are made in the "Notes to the Financial Statements," which follow the financial statements. (The failure of any column of numbers to add to its respective total is due to rounding or truncation.)

There may have been differences found in the course of this examination, which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial with respect to their effect on the financial statements. Therefore, they were communicated to the Company and noted in the workpapers for individual annual statement items.

### ADMITTED ASSETS

Bonds (Note 1)	\$5,568,905
Stocks (Note 1)	1,996,282
Real Estate	37,352
Cash on Deposit (Note 2)	1,950,242
Premiums/Assessments/Agent's Balances Uncollected	113,066
Federal Income Tax Recoverable	13,124
Office Furniture and Fixtures	6,569
Interest Due and Accrued	<u>10,882</u>
 <b>Total Assets</b>	 <u>\$9,696,422</u>

### LIABILITIES, SURPLUS AND OTHER FUNDS

Losses Unpaid	\$63,193
Ceded Reinsurance Payable	18,278
Unearned Premium	741,647
Federal Income Tax Payable	0
Employee Tax Payable	1,339
Premiums Collected in Advance	<u>20,455</u>
 <b>Total Liabilities</b>	 <u>\$844,912</u>

Guaranty Fund (Note 3)	\$690,000
Other Surplus	<u>\$ 8,161,510</u>
 <b>Total Policyholder Surplus</b>	 <u>\$8,851,510</u>
 <b>Total Liabilities and Policyholder Surplus</b>	 <u>\$9,696,422</u>

### STATEMENT OF INCOME

Net Assessment/Premium Income	\$1,265,798
Other Insurance Income	34,339
<i>Less:</i> Net Losses	(670,924)
<i>Less:</i> Underwriting Expenses	<u>(328,615)</u>
Underwriting Income (Loss)	300,598
Net Investment Income	353,207
Other Income	<u>485</u>
Gross Profit or (Loss)	654,290
<i>Less:</i> Federal Income Tax	<u>(52,756)</u>
Net Profit or (Loss)	<u>\$601,534</u>

### CAPITAL AND SURPLUS ACCOUNT

Policyholders' Surplus December 31, 2004	\$8,249,976
Net Income (reported by the Company)	601,534
Examination Changes (Net)	<u>(0)</u>
Policyholders' Surplus, December 31, 2005	<u>\$8,851,510</u>

## NOTES TO THE FINANCIAL STATEMENTS

**Note 1, Bonds** **\$5,568,905**

The Bonds account was decreased by \$1,996,282. This is a reclassification of Bonds to Stocks. The Company included Mutual Funds on the Bonds line, although the Mutual Funds investments are largely invested in the bond market, mutual funds are still considered stocks.

**Note 1, Stocks** **\$1,996,282**

The Stock account was increased by \$1,996,282. This is a reclassification of Bonds to Stocks. The Company included Mutual Funds on the Bonds line, although the Mutual Funds investments are largely invested in the bond market, mutual funds are still considered stocks.

**Note 2, Cash on Deposit** **\$1,950,242**

The Company has investments that are being listed as Certificates of Deposit. These five investments are with Amerprise Financial and do not appear to be FDIC guaranteed which does not comply with Section 380.471 RSMo. The Company should obtain documentation from Amerprise Financial to verify that these CDs are indeed FDIC guaranteed or seek approval from the Department of Insurance. The FDIC only insures Certificates of Deposits up to \$100,000. All five of these CDs are over that threshold.

**Note 3, Guaranty Fund** **\$690,000**

The Company is overstating its Guaranty Fund by \$540,000. The change has no impact on total surplus. Management should gain an understanding of the calculation for the Guaranty Fund.

## EXAMINATION CHANGES

None.

## **GENERAL COMMENTS AND RECOMMENDATIONS**

### *Management and Control, page 5*

The Company does not have a policies and procedures manual as recommended in the previous examination. Development of such a manual would help ensure clear and consistent understanding of the Board's direction and policies. For example, a Board policy regarding investments would provide a long-term strategy for the Company's investment practices and help ensure compliance with statutory limitations. Parts of the assets reviewed during this examination should have been non-admitted because they were not approved investments pursuant to Section 380.471 RSMo. All of the Company stocks are limited to the 20% and 5% rule in aggregate with the bonds pursuant to 20 CSR 200 -12.020.

Also, the cash investments are over the \$100,000 FDIC insured deposit limit. It is recommended that the Company establish a comprehensive investment policy that will identify the types of investment this company wishes to invest in. A comprehensive policy would identify other investment opportunities that meet the Board's long-term goals with respect to liquidity, risk and return objectives and compliance with statutory and regulatory limits.

The Board should develop a comprehensive policies and procedures manual to ensure consistent application of the Board's directions. An investment policy should be included that ensures compliance with statutory and regulatory requirements.

*Policy Forms and Underwriting Practices, page 8*

The Board should obtain written agreements with all its agents.

*Growth and Experience, page 9*

The growth and size of this Company emphasizes the need for improvements in its organizational structure. The management agreement the Board developed in response to a previous examination recommendation lists several responsibilities of the manager. However, because all these duties are vested in one individual, there is no segregation of duties. This is a critical internal control that is missing in this Company. Implementation of this internal control is especially important since the Company does not have an annual independent audit.

The Board should consider a separate claims adjusting function within the Company. The aggregate excess of loss reinsurance arrangement places a large portion of the loss payment responsibility directly on the Company. This responsibility, coupled with the increased reporting and operational responsibilities of the manager, illustrates the need for a separate adjuster. This would also help to improve the segregation of duties issue discussed above.

## **SUBSEQUENT EVENTS**

There were no significant subsequent events.

## ACKNOWLEDGMENT

The assistance and cooperation extended by the directors, officers and employees of the Farmers and Laborers Cooperative Insurance Association of Audrain County in the course of this examination is hereby acknowledged and appreciated.

## VERIFICATION

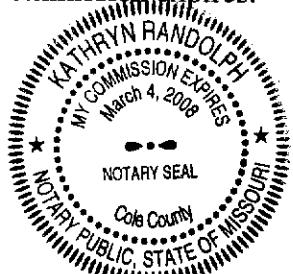
State of Missouri      )  
                            ) ss  
County of Cole      )

I, Larry J. Kleffner, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of the company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

*Larry J. Kleffner, CFE*  
Larry J. Kleffner, CFE  
Financial Examiner  
Missouri Department of Insurance

Sworn to and subscribed before me this 3<sup>rd</sup> day of October, 2006.

My commission expires:



*Kathryn Randolph*  
Notary Public

## SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved.

*Frederick G. Heese*  
Frederick G. Heese, CFE, CPA  
Audit Manager – Kansas City  
Missouri Department of Insurance